California weighs sweeping reforms in insurance regulations, amid mounting wildfire risk

The Hill

The raging wildfires that have become a mainstay in certain California communities are not only devastating family dwellings — they are also impeding Californians from procuring the insurance necessary to protect these homes in the future.

Aiming to both quell soaring prices and bring back firms that have left the Golden State, regulators are proposing sweeping reforms that they believe could revive a competitive insurance market.

While experts agree that the status quo may no longer be sustainable, opinions remain divided on the merits of the proposed changes — which some fear could drive up prices further.

“The situation is hurting consumers badly,” Amy Bach, executive director of the consumer advocacy group United Policyholders, told The Hill.

“It doesn’t feel like it’s going to resolve on its own,” Bach added.

California Insurance Commissioner Ricardo Lara last week called for public input on the final phase of his wildfire modeling regulation, which is many months in the making and has sparked significant debate.

Lara’s strategy would update Proposition 103, a 1988 ballot measure that served “to protect consumers from arbitrary insurance rates and practices” and encouraged a competitive and fair marketplace, according to the Insurance Commission.

Proposition 103 determined that rate changes could only occur with the authorization of the

commissioner, while also establishing a public participation process in which so-called “intervenors” could provide technical input and recover associated costs.

Lara’s office said in a press statement that his update aims to close a loophole in Proposition 103: Insurance firms today can request rates at any level to help compensate for an increased risk of losses but are not required to cover all Californians.

The new regulation, in contrast, would require companies to insure properties in distressed regions at a rate equivalent to 85 percent of the firm’s statewide market share.

In addition, the proposal would incorporate the state’s first use of “catastrophe modeling,” localized simulations of potential risk based on historical analyses and probabilistic calculations that such events will occur in the future.

Whether relying upon such simulations, also known as “cat models,” would end up lowering or raising consumer rates, however, is a matter of contention.

Those in favor of employing these tools argue that other states have long done so and that proactive efforts to adapt California homes to a changing climate could mitigate risk.

“Over the past several years, the state has put billions toward wildfire mitigation efforts and homeowners have made significant investments in home hardening,” Lara said in a statement.

“This is not accounted for by our existing retrospective, past-focused models for ratemaking,” the commissioner continued. “We want consumers to reap the full benefits of these efforts through modern, forward-looking models on how rates are calculated.”

But others are far less certain that the models would account for such improvements — especially because the technology is often proprietary.

Bach cited catastrophe models as a reason for her muted enthusiasm about Lara’s proposal. Yet she expressed willingness “to let the commissioner’s sustainable insurance strategy go into place.”

“If it doesn’t work, then I guess we go back to the drawing board,” Bach said, expressing approval for the

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mandatory coverage component of the regulation.

Bach stressed that thus far, she has seen no indication that catastrophe models, when applied to wildfire-prone areas, are accounting for active mitigation efforts in price determinations. She also expressed concern that wildfire models are much newer than those for, say, hurricanes.

“We are nervous,” she continued. “The reality is that prices are so high already, and affordability is so low right now.”

Nonetheless, Bach acknowledged that California’s lack of catastrophe models was contributing to the exodus of insurance companies from the state. Beginning in 2022 and 2023, many big firms stopped offering services to new customers, often citing wildfire risk.

“The writing was on the wall that cat models are going to come to California, just for practical reasons,” she acknowledged.

“We’re glad at least there’s a quid pro quo — that as a condition of insurers getting to use cat models, they also have to pledge to insure more homes in the areas that have been abandoned,” Bach added.

Harvey Rosenfield, founder of Consumer Watchdog and the author of Proposition 103, decried the use of proprietary catastrophe models that have not been subject to public review as “completely unjust, untested and unreliable.”

“Models are cloaked in the guise of technological infallibility, but they are drafted, they’re written, they’re controlled by humans,” Rosenfield told The Hill.

He also argued that their use would violate provisions of the voter-approved Proposition 103, because this would deny consumers their legal right to examine the details of these models.

“Nobody has the power to rewrite Proposition 103 to eliminate its protections,” Rosenfield added.

The applicability of catastrophe models to wildfire risk assessments was one focal point in a June 2024 working paper about the adaptation of insurance markets to a changing climate. Although these models have improved the ability of insurers to gauge wildfire risk, the resultant projections remain “inherently

uncertain," according to the paper, published by the National Bureau of Economic Research.

"The modern catastrophe models bring a lot of value to insurance pricing and rate setting," co-author Judson Boomhower, assistant professor of economics at the University of California San Diego School of Social Sciences, told The Hill.

"They give you a much more nuanced view of risk for a given property or a given area," added Boomhower, who is also a faculty research fellow at the National Bureau of Economic Research.

That more detailed vantage point, he explained, is more sophisticated than the "backward-looking historical rate-setting methods that insurers have been required to use in California."

Nonetheless, Boomhower also recognized that catastrophe models "are sort of a black box" due to their proprietary nature and resultant questions of transparency.

"Those are legitimate challenges for regulators to think about, but at a high level, this is the best scientific method for assessing catastrophe risk," he said.

Boomhower described Florida as "a little bit ahead" of California from this perspective, as the state requires companies to give regulators some insight into how their individual models work.

In the working paper, Boomhower and his colleagues reconstructed pricing formulas used in California by six major insurers — combining data from company-provided premiums with proprietary information from about 100,000 households.

The authors found that following the 2017 and 2018 wildfire seasons, both premiums and the rate of policy cancellations in high-risk areas surged. They also observed increasing reliance on the state's "quasi-private insurer of last resort" — called California FAIR — the basic but expensive property insurance provided when traditional coverage is unavailable.

Among the paper's key findings was the fact that insurers exhibited "striking variation" in how firms priced wildfire risk, with some only divided the market roughly, at the zip-code-level, and pricing risk at a more granular level — using catastrophe models.

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“There’s tons of heterogeneity in wildfire loss risk, even within zip codes or even within neighborhoods,” Boomhower said.

Insurers with less sophisticated models seemed to end up with a slew of higher-risk customers and greater-than-expected costs, which the authors dubbed the “winners’ curse.”

Meanwhile, they found that companies using the more granular models tended to attract lower-risk customers. With that in mind, Boomhower projected that there would be “a lot of competition among insurance companies to find the low-risk homes in these designated high-risk areas.”

“There are parts of the state where wildfire risk has increased really rapidly,” he continued. “Those are places where insurance rates probably do need to go up relative to where they’ve been historically, just to reflect the increasing risk.”

To the extent that Proposition 103 has held rates down, Boomhower acknowledged that the proposed updates could end up raising prices.

“On the other hand, that may be what you need to ensure availability in some of those places,” he said.

While the status quo may not be ideal for anyone, Rosenfield stressed his belief that insurance firms might come back to California without a change in regulation — simply because it will be in their financial interest to do so.

“California is the biggest single insurance market in the planet, and they’re just going to come back in and take advantage of that,” he said.